



House of Representatives

General Assembly

File No. 511

February Session, 2002

Substitute House Bill No. 5550

House of Representatives, April 16, 2002

The Committee on Finance, Revenue and Bonding reported through REP. MCDONALD of the 148th Dist., Chairperson of the Committee on the part of the House, that the substitute bill ought to pass.

AN ACT PROTECTING THE STATE'S CORPORATION BUSINESS TAX REVENUE.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. Section 12-226a of the general statutes is repealed and the
2 following is substituted in lieu thereof (*Effective from passage and*
3 *applicable to income years commencing on or after January 1, 2002*):

4 If it appears to the Commissioner of Revenue Services that any
5 agreement, understanding or arrangement exists between the taxpayer
6 and any other corporation or any person or firm, whereby the activity,
7 business, income or capital of the taxpayer within the state is
8 improperly or inaccurately reflected, the Commissioner of Revenue
9 Services is authorized and empowered, in his or her discretion,
10 provided such discretion is not arbitrarily, capriciously or
11 unreasonably exercised, and in such manner as he or she may
12 determine, to adjust items of income, deductions and capital, and to

13 eliminate assets in computing any apportionment percentage under
 14 this chapter, provided any income directly traceable thereto shall also
 15 be excluded from entire net income, so as equitably to determine the
 16 tax. Where [(a)] (1) any taxpayer conducts its activity or business under
 17 any agreement, arrangement or understanding in such manner as
 18 either directly or indirectly to benefit its members or stockholders, or
 19 any of them, or any person or persons directly or indirectly interested
 20 in such activity or business, by entering into any transaction at more or
 21 less than a fair price which, but for such agreement, arrangement or
 22 understanding, might have been paid or received therefor, or [(b)] (2)
 23 any taxpayer, a substantial portion of whose capital stock is owned
 24 either directly or indirectly by another corporation, enters into any
 25 transaction with such other corporation on such terms as to create an
 26 improper loss or to reflect inaccurate net income, the Commissioner of
 27 Revenue Services may include in the entire net income of the taxpayer
 28 the fair profits, which, but for such agreement, arrangement or
 29 understanding, the taxpayer might have derived from such
 30 transaction. Not later than January 1, 1995, the commissioner shall
 31 adopt regulations, in accordance with the provisions of chapter 54,
 32 setting forth standards for taking the actions authorized under this
 33 section.

34 Sec. 2. (*Effective from passage*) The General Assembly hereby affirms
 35 that the facts, circumstances and transactions at issue in Carpenter
 36 Technology Corp. v. Commissioner, 256 Conn. 455 (2001), amply
 37 satisfy the improper or inaccurate reflection of net income standard
 38 adopted by the General Assembly in the enactment of section 12-226a
 39 of the general statutes and were properly the subject of an adjustment
 40 by the Commissioner of Revenue Services pursuant to said section 12-
 41 226a.

This act shall take effect as follows:	
Section 1	<i>from passage and applicable to income years commencing on or after January 1, 2002</i>
Sec. 2	<i>from passage</i>

FIN *Joint Favorable Subst.*

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either House thereof for any purpose:

OFA Fiscal Note**State Impact:**

Fund-Type	Agency Affected	FY 03 \$
GF - Precludes a Revenue Loss	Department of Revenue Services	See Below

Note: GF=General Fund

Municipal Impact: None

Explanation

The bill is intended to preclude a significant (\$10 to \$25 million per year) General Fund revenue loss by prohibiting certain expenses to be deducted in calculating net income for corporation tax purposes.

OLR Bill Analysis

sHB 5550

AN ACT PROTECTING THE STATE'S CORPORATION BUSINESS TAX REVENUE**SUMMARY:**

The law allows the revenue services commissioner to adjust a corporation's reported Connecticut income, deductions, capital, and assets under the corporation tax, if he determines the company has an agreement, understanding, or arrangement with another company that gives an inaccurate or improper reflection of its Connecticut business, income, or capital. This bill specifies that (1) the facts, circumstances, and transactions of the *Carpenter Technology* case meet the legal standard for making such an adjustment and (2) the commissioner was justified in making adjustments in that case. It thus bars other companies from using the kinds of transactions that Carpenter Technology used to reduce or avoid state corporation tax liability.

Carpenter Technology set up a Delaware subsidiary; capitalized it with \$300,005,000; and, a few days later, borrowed all but \$5,000 back. Carpenter paid interest on the loan and deducted the interest, saving \$196,102 in Connecticut corporation taxes for 1990 and 1991. The revenue services commissioner determined the loan had no valid business purpose and disallowed the interest deduction. But a Superior Court ruling, affirmed by the Connecticut Supreme Court, held the disallowance was unreasonable because Carpenter's arrangement did not result in an improper or inaccurate reflection of income (*Carpenter Technology v. Commissioner of Revenue*, 47 Conn. Sup. 122 (2000); *Carpenter Technology Corp. v. Commissioner of Revenue Services*, 256 Conn. 455 (2001)).

The bill also prohibits the commissioner from exercising his authority to make adjustments in an arbitrary, capricious, or unreasonable way.

EFFECTIVE DATE: Upon passage and applicable to income years starting on or after January 1, 2002.

COMMITTEE ACTION

Finance, Revenue and Bonding Committee

Joint Favorable Substitute

Yea 43 Nay 0